Alberta Capital Finance Authority

2006

Annual Report

ACFA

ALBERTA CAPITAL FINANCE AUTHORITY

CONTENTS

DIRECTORS

BOARD OF DIRECTORS

Appointed

C.F. Barth
R. Bhatia
F.W. Clarke
L.R. Gordon
S. Ewart-Johnson

Elected

L. Walker	- Representing Class B shareholders
E.A. Gibbons	- Representing Class C shareholders
L.G. Mann	- Representing Class D shareholders
D.O. Lussier	- Representing Class E shareholders

AUDIT COMMITTEE

C.F. Barth	- Chair of the Audit Committee
H.N. Johnsrude	- Member
L. Walker	- Member

OFFICERS

D.O. Lussier	- Chair of the Board
L.R. Gordon	- Vice-Chair
T.S. Stroich	- President and Treasurer
L. Epp	- Vice-President
J. Hui	- Corporate Secretary and Assistant Treasurer

For more information, visit our website or contact the
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ORGANIZATION

Mission

To provide local authorities within the Province with flexible funding for capital projects at the lowest possible cost, consistent with the viability of the Alberta Capital Finance Authority.

Authority

The Alberta Capital Finance Authority is a non-profit Authority established in 1956 under the authority of the *Alberta Capital Finance Authority Act*, Chapter A-14.5, Revised Statutes of Alberta 2000, as amended.

Shareholders

The authorized stock of the Authority consists of the following shares with a par value of $10 each:

- 4,500 Class A, available only to the Crown
- 1,000 Class B, available only to municipal authorities (defined as including improvement districts, metis settlements, municipal districts, counties, special areas, and specialized municipalities) and to regional authorities (includes drainage districts, irrigation districts, regional airport authorities and regional services commissions), and health authorities (includes approved hospitals, mental health hospitals, regional health authorities, and provincial health boards)
- 750 Class C, available only to cities
- 750 Class D, available only to towns and villages
- 500 Class E, available only to educational authorities (includes school districts and divisions, colleges, technical institutes, universities and Northland School Division)

The business of the Authority is administered by a Board of Directors. The Lieutenant Governor in Council appoints up to five directors to represent the Class A common shareholder. Each of the other four classes of shareholders elects one director to the Board.

Loans

Maximum terms of loans for various projects are prescribed in the Authority's resolution relating to the terms and conditions for lending money to shareholders.

Financing

The Authority issues various debt obligations to obtain the funds necessary to finance loan requirements. These obligations of the Authority carry the unconditional guarantee of the Province of Alberta.

CHAIR'S REPORT

February 21, 2007

It is my privilege and pleasure to present the 50th Annual Report of the Alberta Capital Finance Authority for the year ended December 31, 2006, and to review its activities over the past year.

The Authority has completed 50 years of service to Albertans and celebrated its 50th Anniversary on March 29, 2006, fifty years to the day when legislation establishing the Authority was proclaimed. Those who attended the anniversary luncheon were treated to an enjoyable review of the past 50 years, not only about its activities but also about the staff and Board who served the Authority and its shareholders so faithfully. The Authority provided a special insert in the 2005 Annual Report outlining its past and these are still available from the Authority or from its website.

In September 2006, the Authority again conducted a "Consultative Survey" to gauge the level of satisfaction and priorities of our current business practices. I would like to thank everyone who participated as your comments are a key input into the development of our 3-year Business Plan. I am happy to report that in almost all areas surveyed, there has been a significant increase in the levels of satisfaction, and especially for assistance in providing loans, and the timeliness in handling loan applications, considered high priorities by our respondents. This is a testament to the hard work and dedication of the staff over the past two years.

The past year has been a very busy one for the Authority. 2006 saw over $1.048 billion in new loans issued, the second highest on record. It is interesting to note that loans of $840 million in 1981 and $1.1 billion in 1982 were issued during a period when interest rates were at their highest, while in 2006, rates were near their lowest.

The large increase in new loans and maturing debt necessitated the borrowing of over $1.178 billion including over $325 million from the Canada Pension Plan Investment Board for 20 and 25-year terms, $600 million in a public issue for 10-years, $78 million in private placements, and $175 million in short-term financing which was repaid before the end of the year.

Interest rates remained at near historical lows with short-term rates, 3 to 5-years, opening at 4.0%, rising to over 4.50% in June and declining to 4.08% by December. Long-term rates opened at above 4.50%, increased to over 5.0% through May, June and July and then slowly declined to 4.51% by the end of the year.

The Authority's goal is to continue to operate on a break-even basis while retaining a minimum yet positive level of retained earnings. During the year the Authority was able to reduce its interest expense which produced a small positive income of just over $4 million.

The Board has seen further changes in 2006 with the creation of an Audit Committee and the addition of Lynn Walker, representing the Class B shareholders, Lynn replaced our former Vice-Chair Harold Johnsrude, who retired after 6-years of Board service. In December 2006, the new Deputy Ministers of Finance and Municipal Affairs and Housing, Robert Bhatia and Shelley Ewart-Johnson were appointed to the Board. The former Deputy Ministers, Dan Bader, retired, and Brian Manning moved to another portfolio. I would like to thank Harold, Dan and Brian for their dedication and service to the Authority.

I wish to thank the rest of the Board for their time and effort on your behalf and a very sincere appreciation to the staff for their effort and diligence in providing you, our shareholders, and the Board with outstanding service and support.

Don Lussier
Chair

The following provides management's analysis of the financial position and results of operations of the Alberta Capital Finance Authority for the year ended December 31, 2006.

Loans

During 2006, the Authority loan portfolio increased from $4,301 million to $4,903 million, an increase of $602 million. New loans issued during the year totalled $1,048 million, an increase of $396 million from new loans issued in 2005 and loan repayments totalled $446 million. The Authority is forecasting that loan demand will be strong over the next few years, with increasing demands by the educational, municipal and health sectors. Included in this review is an Analysis of New Loans Issued in 2006 by Jurisdiction and Purpose, a Schedule of Loans Outstanding at December 31, 2006 and the Ten-Year Loan Review 1997-2006.

Analysis of New Loans Issued
By jurisdiction and purpose for the year ended December 31, 2006
(thousands of dollars)

	Cities	Towns	Villages	Other	Total
Sewer and water	$ 264,031	$ 6,609	$ 667	$ 162,863	$ 434,170
Electric, gas and telphone	174,937	–	–	–	174,937
Health - ancilliary operation	–	–	–	99,673	99,673
Parks and recreation	41,287	9,239	–	19,079	69,605
Student residences and ancilliary operation	–	–	–	60,863	60,863
Roads and sidewalks	30,435	9,042	400	5,796	45,673
Municipal buildings	20,929	10,739	300	6,233	38,201
Equipment and machinery	25,160	1,104	25	10,037	36,326
Transit	27,000	–	–	–	27,000
Airport infrastructure	–	–	–	20,000	20,000
Land	14,600	–	–	–	14,600
Landfill development	13,120	100	–	22	13,242
ME *first!*	3,608	1,938	175	45	5,766
Senior citizen lodges	715	–	–	3,250	3,965
Public housing	3,650	–	–	–	3,650
Total	**$ 619,472**	**$38,771**	**$ 1,567**	**$ 387,861**	**$1,047,671**

Schedule of Loans Outstanding

as at December 31, 2006
(thousands of dollars)

	Principal Outstanding 31-Dec-05	2-Jan-06 to 31-Dec-06 New Loans Issued	2-Jan-06 to 31-Dec-06 Principal Repaid	Principal Outstanding 31-Dec-06
By Jurisdiction				
Cities	$ 2,535,330	$ 619,472	$ 272,143	$ 2,882,659
Specialized Municipalities	135,727	159,519	10,818	284,428
Towns	247,714	38,771	25,711	260,774
Villages	9,917	1,567	1,361	10,123
Counties	84,855	37,176	20,013	102,018
Municipal Districts	17,397	7,940	3,262	22,075
Irrigation Districts & Regional Services Commissions	89,104	2,690	4,129	87,665
Regional Airport Authorities	390,000	20,000	–	410,000
Health Authorities	64,163	99,673	28,777	135,059
Colleges , Technical Institutes & Universities	319,369	60,863	12,379	367,853
School Districts & Divisions	407,741	–	67,756	339,985
	$ 4,301,317	$1,047,671	$ 446,349	$ 4,902,639
By Purpose				
Municipal - General	$ 2,627,528	$ 686,432	$ 285,961	$ 3,027,999
Municipal - Utility	478,297	174,937	47,754	605,480
ME *first!*	12,978	5,766	3,176	15,568
Airport Infrastructure	390,000	20,000	–	410,000
Health - Ancillary Operation	65,027	99,673	29,301	135,399
Student Residence, Parkade and Ancillary Operation	319,369	60,863	12,379	367,853
School - Core Operation	408,118	–	67,778	340,340
	$ 4,301,317	$1,047,671	$ 446,349	$ 4,902,639

Ten-Year Loan Review 1997-2006
(thousands of dollars)

	2006	2005	2004
New loans issued during the year:			
By jurisdiction:			
Cities	$ 619,472	$ 355,350	$ 377,445
Specialized municipalities	159,519	6,794	15,115
Towns and villages	40,338	44,219	53,569
Counties, municipal and irrigation districts, and regional services commissions	47,806	49,656	43,542
Regional airport authorities	20,000	75,000	20,000
Health authorities	99,673	37,920	19,000
Colleges, technical institutes and universities	60,863	82,998	71,112
School districts and divisions	–	–	7,680
Total	**$1,047,671**	**$ 651,937**	**$ 607,463**
By purpose:			
Municipal	$ 861,369	$ 446,841	$ 484,135
ME *first!*	5,766	9,178	5,536
Airport infrastructure	20,000	75,000	20,000
Health – ancillary operation	99,673	37,920	19,000
Student residence, parkade and ancillary operation	60,863	82,998	71,112
School – core operation	–	–	7,680
Total	**$1,047,671**	**$ 651,937**	**$ 607,463**
Loans repaid during year	446,349	500,825	397,916
Loans outstanding at December 31	4,902,639	4,301,317	4,150,205
New debt issued during year (at par)	1,178,396	972,000	714,500
Debt repaid during year	570,396	832,604	475,491
Debt outstanding at December 31	4,963,963	4,355,963	4,216,567
Sinking fund investments at December 31	–	–	–
Retained earnings at December 31	15,674	11,673	12,664
Lending rate at December 31 *(based on 20-year term)*	4.365%	4.569%	4.923%

2003	2002	2001	2000	1999	1998	1997
$ 379,647	$ 255,139	$ 297,004	$ 226,820	$ 157,516	$ 115,738	$ 137,631
26,830	17,742	13,133	38,741	20,226	10,233	5,906
31,122	20,211	25,657	29,726	24,044	16,268	15,025
40,056	10,489	9,449	2,815	14,431	2,785	3,816
–	370,000	–	–	–	–	–
–	–	–	–	–	10,000	–
19,302	91,300	17,825	66,300	17,975	–	–
–	1,260	271	5,033	2,294	5,080	2,246
$ 496,957	**$ 766,141**	**$ 363,339**	**$ 369,435**	**$ 236,486**	**$ 160,104**	**$ 164,624**
$ 477,655	$ 303,581	$ 345,243	$ 298,102	$ 215,967	$ 144,774	$ 162,378
–	–	–	–	–	–	–
–	370,000	–	–	–	–	–
–	–	–	–	–	10,000	–
19,302	91,300	17,825	66,300	17,975	–	–
–	1,260	271	5,033	2,544	5,330	2,246
$ 496,957	**$ 766,141**	**$ 363,339**	**$ 369,435**	**$ 236,486**	**$ 160,104**	**$ 164,624**
410,372	418,565	456,062	427,095	422,002	562,723	495,961
3,940,658	3,854,073	3,506,497	3,599,220	3,656,880	3,842,396	4,245,015
3,137,000	2,280,000	725,000	592,367	–	–	–
2,930,523	1,929,735	776,739	1,002,367	294,206	226,645	175,457
3,977,558	3,771,081	3,420,816	3,472,555	3,882,555	4,176,761	4,403,406
–	–	–	–	450,153	417,639	385,304
22,406	26,676	132,738	149,913	275,656	318,602	333,505
5.625%	5.875%	6.000%	6.125%	6.500%	5.625%	6.000%

Results of Operations

The Authority's interest income on loans, including amortization and income from investments exceeded interest expense on debt by $2.8 million, as the yield on the loans was slightly higher than the yield on the debt which resulted in net income of $4 million for 2006.

The Authority's goals are to provide local authorities with flexible funding at the lowest possible cost and to maintain the lowest administrative and new loan costs compared to other municipal borrowing authorities. Included is a comparison of the Authority's 2006 costs with the latest audited financial data of other provincial municipal borrowing authorities.

Capital Finance Authority Statistics - 2006

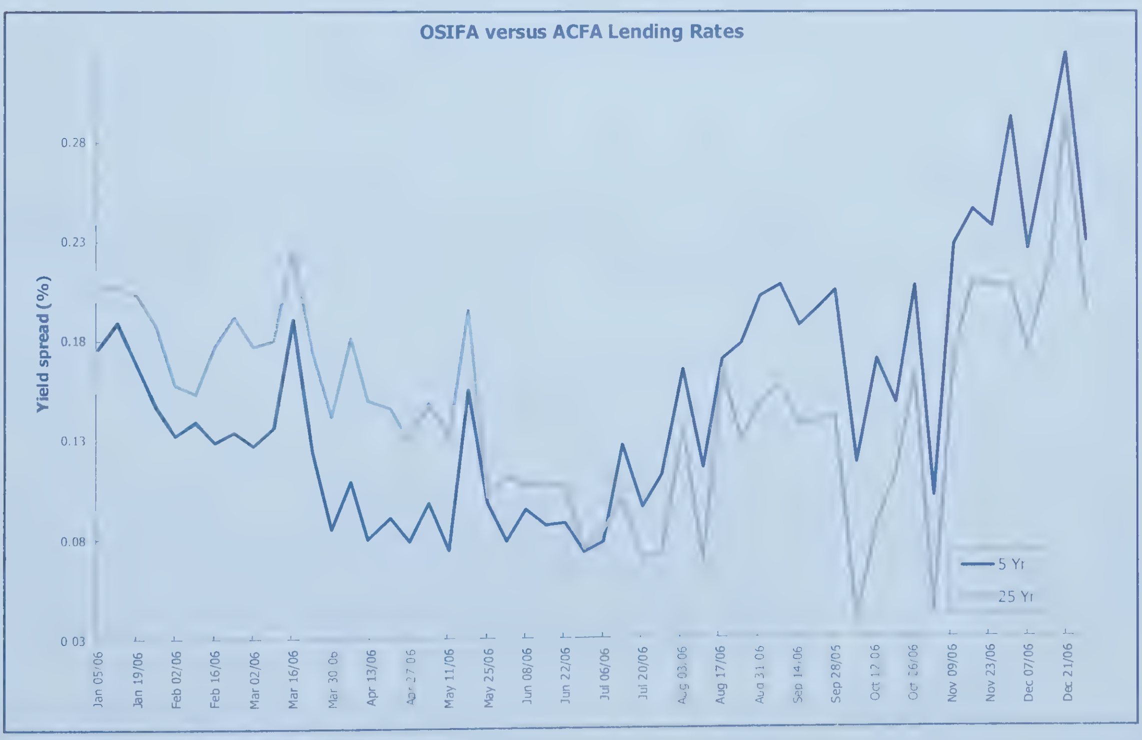
	Alberta	British Columbia	Nova Scotia
New loans to shareholders			
($ millions)	1,048	588	112
Total loans outstanding, net of unamortized discount			
($ millions)	4,899	3,406	621
Administrative expense			
($ thousands)	881	1,398	282
($ per $ thousand of new loans)	.84	2.38	2.52
($ per $ million of loans)	.18	.41	.45

Interest Rates

The Authority provides fixed rate semi-annual pay amortizing loans to its borrowers. Loan rates are based on actual rates for the interest rate swaps (or other floating rate instruments) executed to convert the loan to a floating rate to match the funding floating rate in order to reduce interest rate risk to the Authority. If a fixed rate instrument is used to fund the loan, then the loan rate will be based on the actual rate of the fixed rate instrument.

Comparative Loan Spreads with OSIFA

In order to compare the Authority's loan rates provided to those of Ontario municipal borrowers, rates of the Ontario Strategic Infrastructure Financing Authority (OSIFA) were reviewed and compared to the rate that the Authority would have offered. As noted below ACFA's rates were consistently below OSIFA's throughout the year. Lending rates for OSIFA's 5 and 25-year loans were 7 to 28 basis points above ACFA's rates. The Authority's goal is to provide the lowest rate for Alberta borrowers.



Debt

The gross debt of the Authority increased by $608 million to $4,964 million. During the year, the Authority received $446 million in loan repayments while issuing $1,048 million in new loans. The Authority repaid $395 million to the Canada Pension Plan Investment Fund. During the year the Authority borrowed $1,003 million in medium and long-term debt for terms from 5 to 20-years and to meet short-term requirements, borrowed over $175 million, all of which was repaid during the year.

Sources of Capital
(thousands of dollars)

	Gross Outstanding December 31, 2006	Outstanding as a Percentage of Total
Canada Pension Plan Investment Fund	$ 1,525,567	30.7%
Canada Pension Plan Investment Board	325,396	6.6%
Public	3,113,000	62.7%
Total	$ 4,963,963	100.0%

Risk Management

Effective risk management is central to the ability to ensure a financially sound organization and includes identifying, assessing, managing and monitoring all forms of risk. The Authority is primarily exposed to:

- Market risk
- Liquidity risk
- Operational risk and
- Credit risk

The President of the Authority is responsible for identifying risks and recommending the appropriate policies and framework. The Board of Directors reviews and approves the risk management policies and implements specific reporting procedures to enable them to monitor the adherence to these policies.

Market Risk

Market risk is the impact on the Authority's income from changes in market factors such as interest rates and foreign exchange. The Authority requires that all borrowing be done in Canadian dollars or that borrowing in foreign currency be swapped into Canadian dollars. The primary source of interest rate risk is repricing risk which arises when there is a mismatch between the maturity and repricing of interest bearing assets and liabilities. This repricing risk also results from the Authority's willingness to allow for some prepayments on existing loans.

The prepayment policy is structured to protect the Authority from the significant losses that would occur in accepting additional prepayments of high interest rate loans and relending these funds at lower rates. The Authority, on three separate occasions, has reduced the rates on higher interest rate loans to 12%. The Authority does not have the ability to prepay or refinance its public debt and can only repay the Canada Pension Plan Investment Fund with a prepayment penalty based on current market rates which would not make it economically advantageous. The Authority's prepayment policy is an integral part of its long-term financial planning.

Interest Rate Risk

The Authority uses mainly interest rate swaps for the purpose of managing its asset and liability position. The Authority's policy is to match the interest rate exposure on all new loans to the interest rate exposure of the debt used to fund these loans. In most cases, fixed interest rates on new loans and debt are swapped to floating rates.

The Board recognizes the unique risks associated with the use of derivative financial instruments and has established policies and procedures to monitor and minimize exposure to the Authority. These policies and procedures limit the type of derivative financial instruments and circumstances where they can be used, the authorities required to approve the transaction and the appropriate segregation of duties to reduce operational risk. All derivative financial instruments are reviewed and managed within policies approved by the Board and the Board reviews all derivative financial instruments made since the last meeting.

Credit risk on counterparty default arises with the use of derivatives. To control this risk, the Authority uses counterparty limits established for the Province and uses only counterparties believed to have a good credit standing (A+ or greater). The Authority is not exposed to credit risk for the full face value (notional amount) of the derivative contracts, but only to the potential replacement cost if the counterparties fail. This exposure is represented by the current replacement cost of all outstanding contracts in a favourable position. For additional information, see Note 8 in the Financial Statements.

Liquidity Risk

Liquidity risk is the risk that the Authority will not have sufficient cash to meet its obligations as they become due and also meet the loan requirements of our local authorities.

The Authority manages its liquidity risk by monitoring its cash flows on a daily basis and providing updated cash flow reports to the Board as required. Surplus funds are invested in short-term investments or the Consolidated Cash Investment Trust Fund. When required, the Authority raises funds under a five-year Promissory Note Program, by direct borrowing in the Canadian or European market or by renewing borrowing from the Canada Pension Plan Investment Fund.

Operational Risk

Operational risk is the risk associated with a breakdown in internal controls, systems or procedural failures, human errors or malfeasance. These risks can never be fully eliminated but are minimized by establishing appropriate policies and sound internal controls through an appropriate segregation of duties, accountability and reporting practices.

The examination of the financial statements was made in accordance with Canadian generally accepted auditing standards and, accordingly, included a review of certain of the systems of operating and financial controls and such tests that were considered necessary in the circumstances.

The objective of a financial statement audit is to obtain reasonable assurance whether the financial statements are free of material misstatement. Accordingly, an audit would not usually identify all matters that may be of interest to management and the Audit Committee, however any weaknesses identified in internal controls over financial reporting controls, or other non-trivial matters, are communicated to management and the Audit Committee.

Credit Risk

Credit risk is the risk of loss due to a borrower failing to meet their obligations to the Authority. Historically, the Authority has not been required to record any provisions or allowances regarding credit losses nor has it suffered any such losses. The Authority has established policies which provide for the approval and monitoring of all lending activity. These policies include establishing clear lines of authority for decision making and for accountability.

Financial Reporting Responsibility of Management

Management of the Alberta Capital Finance Authority prepared these financial statements and is responsible for their reliability, completeness and integrity. They conform in all material respects to Canadian generally accepted accounting principles and the requirements of the *Alberta Capital Finance Authority Act*.

Management maintains the necessary accounting and internal control systems designed to ensure the timely production of reliable and accurate financial information, the protection of assets (to a reasonable extent) against loss or unauthorized use and the promotion of operational efficiency. The Audit Committee oversees management's responsibilities for financial reporting, and internal control systems over financial reporting controls, and recommends approval of the financial statements and annual report to the Board of Directors.

The Auditor General of Alberta is designated as the external auditor in the *Alberta Capital Finance Authority Act*. The Audit Committee reviewed these financial statements with the external auditor in detail before recommending their approval to the Board of Directors. The Board then approved the financial statements.

FCA
President

Edmonton, Alberta
February 14, 2007

Auditor's Report

To the Shareholders of the
Alberta Capital Finance Authority

I have audited the balance sheet of the Alberta Capital Finance Authority as at December 31, 2006 and the statements of income and retained earnings and cash flow for the year then ended. These financial statements are the responsibility of the Authority's management. My responsibility is to express an opinion on these financial statements based on my audit.

I conducted my audit in accordance with Canadian generally accepted auditing standards. Those standards require that I plan and perform an audit to obtain reasonable assurance whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation.

In my opinion, these financial statements present fairly, in all material respects, the financial position of the Authority as at December 31, 2006 and the results of its operations and its cash flows for the year then ended in accordance with Canadian generally accepted accounting principles.

FCA
Auditor General

Edmonton, Alberta
February 14, 2007

Balance Sheet

as at December 31, 2006
(thousands of dollars)

	2006 Budget	2006 Actual	2005 Actual
Assets:			
Cash (Note 3)	$ 78,553	$ 20,800	$ 10,304
Accrued interest receivable	103,597	103,245	109,662
Loans to local authorities (Note 4)	4,472,139	4,898,705	4,293,356
	$ 4,654,289	$ 5,022,750	$ 4,413,322
Liabilities and Shareholders' Equity:			
Liabilities:			
Accrued interest payable	$ 58,590	$ 56,827	$ 53,751
Debt (Note 5 and Schedule 1)	4,589,190	4,950,185	4,347,834
	4,647,780	5,007,012	4,401,585
Shareholders' Equity:			
Share capital (Note 6):			
Issued and fully paid:			
6,384 shares (2005 - 6,378)	64	64	64
Retained earnings	6,445	15,674	11,673
	6,509	15,738	11,737
	$ 4,654,289	$ 5,022,750	$ 4,413,322

The accompanying notes are part of these financial statements.

D.O. Lussier
Chair of the Board

T.S. Stroich, FCA
President

Statement of Income and Retained Earnings

for the year ended December 31, 2006
(thousands of dollars)

	2006 Budget	2006 Actual	2005 Actual
Interest Income:			
Loans	$ 266,699	$ 284,849	$ 277,000
Amortization of loan discounts	4,027	4,027	6,424
Other (Note 3)	4,500	5,517	2,594
	275,226	294,393	286,018
Interest Expense:			
Debt	277,951	290,082	285,312
Amortization of net discounts on debt	760	1,556	796
	278,711	291,638	286,108
Net interest income (expense)	(3,485)	2,755	(90)
Other Income:			
Loan prepayment fees	–	2,127	66
Net interest income (expense) and other income	(3,485)	4,882	(24)
Non-Interest Expense:			
Administration and office expenses (Note 7)	962	881	967
Net income (loss)	(4,447)	4,001	(991)
Retained earnings, beginning of year	10,892	11,673	12,664
Retained earnings, end of year	$ 6,445	$ 15,674	$ 11,673

Statement of Cash Flow

for the year ended December 31, 2006
(thousands of dollars)

	2006		2005
	Budget	Actual	Actual
Operating Activities:			
Interest received	$ 272,627	$ 291,266	$ 289,326
Other interest	4,500	5,517	2,594
Loan prepayment fees	–	2,127	66
Administration and office expenses	(962)	(881)	(967)
Interest paid	(273,052)	(287,006)	(287,890)
Cash flows from operating activities	3,113	11,023	3,129
Investing Activities:			
Loan repayments	409,746	446,349	500,825
New loans issued	(636,000)	(1,047,671)	(651,937)
Cash flows used in investing activities	(226,254)	(601,322)	(151,112)
Financing Activities:			
Debt issues	641,992	1,171,191	967,866
Debt redemptions	(401,396)	(570,396)	(832,604)
Cash flows from financing activities	240,596	600,795	135,262
Net increase (decrease) in cash	17,455	10,496	(12,721)
Cash, beginning of year	61,098	10,304	23,025
Cash, end of year	$ 78,553	$ 20,800	$ 10,304

NOTES TO THE FINANCIAL STATEMENTS

December 31, 2006

(all amounts presented in thousands of dollars, except share amounts)

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1. **Authority**

   The Alberta Capital Finance Authority operates under the authority of the *Alberta Capital Finance Authority Act*, Chapter A-14.5, Revised Statutes of Alberta 2000, as amended. Under the Act, the Authority is restricted to making loans only to its shareholders.

2. **Significant Accounting Policies and Reporting Practices**

   These financial statements have been prepared by management in accordance with Canadian Generally Accepted Accounting Principles (GAAP) and include the following significant accounting policies:

   a) **Debt**

   Debt premiums and discounts, including underwriting commission, arising on the issue of debt are deferred and amortized over the term of the debt.

   Debt is recorded net of unamortized premiums or discounts.

   Public debt issue expenses are charged against income as they are incurred.

   b) **Discounts on Loans to Local Authorities**

   Discounts are recorded for reductions of interest rates given on loans to local authorities with interest rates above a certain level and are amortized to income over the term of these loans. Annual amortization is the change in the present value of the remaining interest rate reduction.

   c) **Measurement Uncertainty**

   The preparation of financial statements in conformity with Canadian GAAP requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosure of contingent assets and liabilities at the date of the financial statements and the reported amount of revenues and expenses during the year. Actual results could differ from these estimates. Measurement uncertainty exists in the collectability of the loans to local authorities and the estimate of fair value of financial instruments.

   d) **Credit Risk**

   Credit risk is the risk of loss due to borrowers failing to meet their obligations to the Authority. Historically, the Authority has not needed to record any provisions or allowances regarding credit losses nor has it suffered any such losses. The Authority has established policies which provide for the approval and monitoring of all lending activity. These policies include establishing clear lines of authority for decision making and for accountability.

   e) **Derivative Financial Instruments**

   Derivative financial instruments used by the Authority are interest rate contracts whose value is derived from interest rates and are used to accommodate the management of risk for asset/liability management purposes and to manage the Authority's interest rate exposure.

To designate a derivative financial instrument as a hedge for accounting purposes, the criteria of Accounting Guideline 13, Hedging Relationships must be met. In order to qualify for hedge accounting, the Authority formally documents all relationships between hedging instruments and hedging items, as well as its risk management objectives and strategy for undertaking various hedge transactions. This process includes linking all derivative financial instruments to specific assets and liabilities. The Authority also formally assesses, both at the hedge's inception and on an ongoing basis, whether the derivative financial instruments that are used in hedging transactions are highly effective in offsetting changes in fair values or cash flows of hedged items.

Derivative financial instruments are accounted for on an accrual basis. Income and expenses on derivative financial instruments designated and qualifying as hedges are recorded as an adjustment to the yield of the item being hedged over the term of the hedge contract in the Statement of Income and Retained Earnings.

Accrued interest receivable and payable on these derivative financial instruments are recorded in accrued interest receivable and payable respectively, in the Balance Sheet.

If the hedge is no longer effective, the associated derivative financial instrument is subsequently carried at fair value on the Balance Sheet and the fair value and any subsequent changes to the fair value are recorded in the Statement of Income and Retained Earnings in other income.

Derivative financial instruments that have been acquired for asset/liability management purposes that do not qualify for hedge accounting are carried at fair value on the Balance Sheet and the fair value and any subsequent changes in the fair value are recorded in the Statement of Income and Retained Earnings in other income.

Accrued income and expenses and deferred gains and losses are included in other assets and other liabilities as appropriate in the Balance Sheet.

f) Financial Instruments and Hedges

The Canadian Institute of Chartered Accountants (CICA) has issued three new accounting standards. CICA Handbook Section 3855, Financial Instruments - Recognition and Measurement, Section 3865, Hedges; and Section 1530, Comprehensive Income. These standards are effective for ACFA beginning January 1, 2007. The principal impacts of the standards are as follows:

Financial assets can be classified as available for sale, held to maturity, trading or loans and receivables. Financial liabilities can be classified as trading or other. All ACFA financial assets and liabilities will be recorded on the balance sheet at fair value and all previously designated hedging relationships will be voluntarily de-designated. All financial assets and liabilities including loans and receivable and long-term debt respectively, will be classified as trading assets and will be accounted for at fair value with realized and unrealized gains and losses reported through net income.

The prospective change to fair value accounting will add the potential for greater volatility to future reporting periods as changes in the fair value of loans, debt and related derivative financial instruments will be measured and recorded in the financial statements. While all of the transitional requirements of voluntarily de-designating existing hedge relationships, designating all loans and debt are held for trading and adopting the other requirements of Sections 3855, 3865 and 1530 have not been assessed, the opening change on adopting this new basis of accounting will be an increase in the net assets of ACFA by approximately $116 million.

3. Cash

Cash is on deposit in the Consolidated Cash Investment Trust Fund of the Province of Alberta which is managed with the objective of providing competitive interest income to depositors while maintaining appropriate security and liquidity of depositors' capital. The portfolio is comprised of high-quality short-term and mid-term fixed-income securities with a maximum term-to-maturity of three years. As at December 31, 2006, securities held by the Fund have an average effective market yield of 4.55% per annum (December 31, 2005 - 3.62% per annum).

4. Loans to Local Authorities

	2006	2005
Loans to local authorities	$ 4,902,639	$ 4,301,317
Less: Unamortized discounts	3,934	7,961
	$ 4,898,705	$ 4,293,356

5. Debt

a) The debt of the Authority is fully guaranteed by the Province of Alberta.

b) Debt amounting to $643,000 (2005 - $565,000) is comprised of a combination of various issues of step-up and accrual notes whereby the Authority has the option of extending or calling the debt, at predetermined extension or call dates. Principal is due upon termination of the debt, where debt is called or not extended by the Authority at the predetermined extension or call date, or upon final maturity of the debt (Schedule 1).

c) For the next five years debt redemption requirements, with the assumption that the step-up and accrual notes are redeemed at the first extendible date and all other debt at the maturity date, are as follows:

	Debt Redemption
2007	$ 978,383
2008	259,294
2009	330,523
2010	200,000
2011	250,000
	$ 2,018,200

6. **Share Capital**
Particulars of share capital are as follows:

		Number of Shares		
Class	**Restricted to**	**Authorized**	**Issued and Fully Paid**	**Total Dollar Amount**
A	Province of Alberta	4,500	4,500	$ 45,000
B	Municipal authorities, airport and health authorities	1,000	865	8,650
C	Cities	750	585	5,850
D	Towns and villages	750	297	2,970
E	Educational authorities	500	137	1,370
		7,500	6,384	$ 63,840

During the year, five Class B and one Class D shares were issued at $10.00 each.

7. **Directors' and Audit Committee Fees and Related Party Transactions**
Directors' and Audit Committee fees paid by the Authority are as follows:

	2006		2005	
	Number of Individuals	**Total**	**Number of Individuals**	**Total**
Board/Audit Committee Chairs	2	$ 7	1	$ 6
Board/Audit Committee members	8	$ 20	6	$ 16

There are two additional Board members who are employees of the Province of Alberta and do not receive compensation from the Authority.

The Authority has advanced loans to local authorities under the ME*first!* Municipal Energy Efficiency Assistance program (the "Program") on behalf of Alberta Municipal Affairs and Housing and Alberta Environment. Under the Program, principal is advanced to qualifying municipalities by the Authority and repayments of principal are made by the municipality; however, the interest is paid by the Province of Alberta. Included in the balance of loans to local authorities at December 31, 2006 is principal of $15,568 (2005 - $12,978), upon which, interest of $215 (2005 - $188) has been recorded in interest income from loans.

The Authority has no employees. Included in administration and office expenses of $881 (2005 - $967) is the amount of $406 (2005 - $417) that was paid to the controlling shareholder, Province of Alberta for goods and services at prices measured at the exchange amount, which approximate market.

8. **Derivative Financial Instruments**

Derivative financial instruments used by the Authority include interest rate swaps and forward rate agreements. The Authority enters into derivative financial instruments for risk management purposes and does not act as an intermediary in this market.

The interest rate contracts are used to manage exposure to fluctuations in interest rates in certain fixed rate loans and related debt made after January 1, 2004.

Notional amounts represent the amount to which a rate is applied in order to calculate the exchange of cash flows. The notional amounts are not recorded in the Balance Sheet. They represent the volume of outstanding transactions and do not represent the potential gain or loss associated with the market risk or credit risk of such instruments.

The notional amounts of derivative financial instruments are summarized as follows:

As at December 31

Maturities	Within 1 Year	1 to 2 Years	3 to 5 Years	6 to 10 Years	Over 10 Years	Total
Interest rate contracts						
Interest rate swaps - 2006	$ 652,290	$ 639	$ 181,175	$ 976,856	$ 2,516,099	$ 4,327,059
Interest rate swaps - 2005	$ 449,000	$ 21,380	$ 102,477	$ 419,070	$ 1,342,707	$ 2,334,634

The cost of replacing the remaining cash flows of the derivative financial instruments at the prevailing prices and market rates are summarized as follows:

As at December 31

			Current Replacement Cost	
	Notional Outstanding	Net Fair Value	Contracts in Favourable Position	Contracts in Unfavourable Position
Interest rate contracts				
Interest rate swaps - 2006	$ 4,327,059	$ (9,993)	$ 39,322	$ (49,315)
Interest rate swaps - 2005	$ 2,334,634	$ (12,393)	$ 27,802	$ (40,195)

Fair values are determined using pricing models which take into account current market and contractual prices of the underlying instruments, as well as time value and yield curve or volatility factors underlying the positions. Fair values have been segregated between those contracts which are in a favourable position (positive fair value) and those contracts which are in an unfavourable position (negative fair value).

Current credit exposure is limited to the amount of loss that the Authority would suffer if every counterparty to which the Authority was exposed were to default at once and is represented by the current replacement cost of all outstanding contracts in a favourable position. The Authority actively monitors their exposure and minimizes credit risk by only dealing with counterparties believed to have a good credit standing (A+ or greater).

9. Interest Rate Risk

Interest rate risk refers to the potential impact of changes in interest rates on the Authority's earnings when maturities of its financial assets are not matched with the maturities of its financial debt. The following table summarizes the carrying amounts of the Authority's interest sensitive assets and liabilities based on the earlier of contractual repricing or principal repayments:

As at December 31

Maturities	Within 1 Year	1 to 2 Years	3 to 5 Years	6 to 10 Years	Over 10 Years	2006 Total	2005 Total
Assets							
Cash	$ 20,800	$ –	$ –	$ –	$ –	$ 20,800	$ 10,304
Accrued Interest Receivable	103,245	–	–	–	–	103,245	109,662
Loans to Local Authorities	489,289	365,556	1,133,947	1,275,270	1,638,577	4,902,639	4,301,317
Effective Rate	6.4%	6.3%	6.0%	5.7%	5.4%	6.0%	6.4%
Total	$ 613,334	$ 365,556	$1,133,947	$1,275,270	$ 1,638,577	$ 5,026,684	$ 4,421,283
Liabilities							
Accrued Interest Payable	$ 56,827	$ –	$ –	$ –	$ –	$ 56,827	$ 53,751
Debt	978,383	259,294	780,523	1,600,000	1,345,763	4,963,963	4,355,963
Effective Rate	6.6%	6.0%	5.4%	5.3%	5.2%	5.7%	6.3%
Total	$1,035,210	$259,294	$ 780,523	$1,600,000	$ 1,345,763	$ 5,020,790	$ 4,409,714
Cumulative Gap	$ (421,876)	$ 106,262	$ 353,424	$ (324,730)	$ 292,814	$ 5,894	$ 11,569

The Authority manages on a continuous basis its interest rate risk by matching its debt maturity profile to the forecast cash flows and their effect on the Authority's surplus position. For most loans made after January 1, 2004, the Authority uses derivative financial instruments to swap fixed rate loans interest to floating, and swap corresponding debt from fixed rate to floating and uses forward rate agreements to minimize the exposure related to the mismatch of reset dates of the loan and debt swaps.

10. Fair Value of Financial Instruments

The amounts set out in the table below represent the fair value of the Authority's financial instruments based on the following assumptions and valuation methods.

Fair value represents the estimated consideration that would be agreed upon in a current transaction between knowledgeable, willing parties who are under no compulsion to act. For loans and debt, fair value is calculated using net present value techniques where the Authority's future cash flows are discounted at the Authority's current cost of funds.

Changes in interest rates are the main cause of changes in the fair value of the Authority's financial instruments.

The fair value of cash approximates its carrying value.

The following table presents the financial instruments with a carrying value different from the fair value at December 31:

	2006		2005	
	Fair Value	**Carrying Value**	**Fair Value**	**Carrying Value**
Loans, including accrued interest receivable	$ 5,349,892	$ 5,001,950	$ 4,826,948	$4,403,018
Debt, including accrued interest payable	$ 5,228,600	$ 5,007,012	$ 4,772,766	$ 4,401,585

Fair value of derivative financial instruments is provided in Note 8.

11. Commitments

Lease
The Authority has obligations under an operating lease for the rental of premises at an annual minimum amount of $25, expiring in July 2008.

Credit Commitments
In the normal course of business, the Authority enters into loan commitments to provide customers with sources of credit.

Commitments to extend credit represent undertakings to make credit available in the form of loans for specific amounts and maturities, subject to certain conditions and are recently authorized loans not yet drawn down.

These loan arrangements are subject to the Authority's normal credit standards and collateral is obtained where appropriate. The loan amounts represent the maximum credit risk exposure to the Authority should the loans be fully drawn. These arrangements will most likely be drawn upon; the loan amounts represent future cash requirements. Loan commitments as at December 31 were:

	2006	2005
Loan commitments as at December 31	$ 30,308	$ 17,381

12. Budget
The 2006 budget was approved by the Board of Directors on November 24, 2005.

Schedule of Debt

As at December 31, 2006 — Schedule 1

(thousands of dollars)

Maturity Date	First Extendible Date	Interest Rate	Principal Outstanding
Canada Pension Plan Investment Fund/CPP Investment Board			
Nov 02, 2007		9.660	$ 335,383
Oct 03, 2008		10.040	259,294
Oct 02, 2009		9.990	291,414
Nov 01, 2009		9.620	32,457
Dec 01, 2009		9.260	6,652
Oct 01, 2020		6.280	222,367
Jun 01, 2022		6.060	100,000
Apr 05, 2023		5.890	50,000
Dec 01, 2023		5.500	150,000
Dec 03, 2024		5.180	78,000
Nov 03, 2026		4.490	200,000
Nov 03, 2031		4.500	125,396
Total			1,850,963
Public			
Mar 24, 2008	Mar 26, 2007	3.200	16,000 (i)
Mar 01, 2010		4.550	50,000
Jun 15, 2010	Jun 15, 2007	4.200	10,000 (i)
Aug 20, 2010		4.500	150,000
Jun 23, 2011	Jun 25, 2007	3.200	10,000 (i)
Sep 01, 2011		5.700	200,000
Sep 06, 2011	Sep 06, 2007	4.300	10,000 (i)
Sep 11, 2011	Sep 11, 2007	4.300	20,000 (i)
Sep 15, 2011	Mar 15, 2007	3.550	10,000 (i)
Dec 15, 2011		4.435	50,000
Dec 15, 2011	Jun 15, 2007	3.450	13,000 (i)
May 11, 2012	May 11, 2007	3.750	10,000 (i)
Jun 01, 2012		5.850	500,000
Aug 28, 2012	Aug 28, 2007	4.300	10,000 (i)
Jun 28, 2013	Jun 28, 2007	3.650	15,000 (i)
Oct 12, 2013	Apr 12, 2007	3.500	10,000 (i)
Oct 30, 2013	Oct 30, 2007	4.250	10,000 (i)
Dec 02, 2013		5.000	300,000
Dec 15, 2014	Jun 15, 2007	4.500	25,000 (i)
Dec 15, 2014	Jun 15, 2007	4.500	30,000 (i)
Mar 23, 2015	Mar 23, 2007	4.350	20,000 (ii)

Maturity Date	First Extendible Date	Interest Rate	Principal Outstanding
Public (continued)			
Mar 30, 2015	Mar 30, 2007	4.100	15,000 (i)
Apr 06, 2015	Apr 09, 2007	4.200	15,000 (i)
Jun 01, 2015		4.900	200,000
Jun 15, 2015	Jun 15, 2007	4.050	10,000 (i)
Jun 15, 2015	Jun 15, 2007	4.150	45,000 (i)
Jun 15, 2015	Jun 15, 2007	4.000	17,000 (i)
Jun 15, 2015	Jun 15, 2007	3.350	15,000 (i)
Jun 23, 2015	Jun 25, 2007	3.750	15,000 (ii)
Jun 28, 2015	Jun 28, 2007	4.300	20,000 (ii)
Sep 15, 2015	Mar 15, 2007	4.240	10,000 (ii)
Dec 15, 2015	Jun 15, 2007	4.150	20,000 (i)
Jun 15, 2016	Jun 15, 2007	4.000	25,000 (i)
Jun 15, 2016		4.350	600,000
May 15, 2017	May 15, 2007	4.000	25,000 (i)
Jun 16, 2017	Jun 18, 2007	4.000	18,000 (i)
Jun 28, 2017	Jun 28, 2007	4.050	30,000 (i)
Aug 15, 2017	Feb 15, 2007	4.000	35,000 (i)
Dec 15, 2017	Dec 15, 2007	4.050	10,000 (i)
Jun 01, 2018		5.150	100,000
Nov 16, 2018	Nov 16, 2007	4.600	18,000 (i)
Dec 01, 2023		5.100	20,000
Jun 15, 2025	Jun 15, 2007	5.150	20,000 (ii)
Jul 06, 2025	Jan 08, 2007	5.020	16,000 (ii)
Dec 15, 2025		4.450	300,000
Oct 11, 2030	Oct 11, 2007	5.160	15,000 (ii)
Dec 15, 2030	Jun 15, 2007	5.160	10,000 (ii)
Dec 15, 2030	Dec 17, 2007	5.410	10,000 (ii)
Dec 15, 2030	Jun 15, 2007	5.400	10,000 (ii)
Total			3,113,000
			4,963,963
Net unamortized discount			13,778
Total debt 2006			$ 4,950,185
Total debt 2005, net of unamortized discount			$ 4,347,834

(i) These are step-up notes extendible at the Authority's option which pay interest periodically at a predetermined rate with principal paid on termination.

(ii) These are accrual notes extendible or callable at the Authority's option which accrue interest semi-annually or annually and pay interest and principal on termination.

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